**STATE OF ILLINOIS**
**ILLINOIS COMMERCE COMMISSION**

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| **TDS Metrocom, LLC** | **)** | |
| **-vs-** | **)** | |
| **Illinois Bell Telephone Company** | **)** | |
| | **)** | **03-0553** |
| **Complaint concerning imposition of unreasonable** | **)** | |
| **And anti-competitive termination charges by** | **)** | |
| **Illinois Bell Telephone Company.** | **)** | |

# INITIAL BRIEF OF SBC ILLINOIS

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## INITIAL BRIEF OF SBC ILLINOIS

Illinois Bell Telephone Company ("SBC Illinois" or "the Company") hereby files its Initial Brief in the above-captioned complaint proceeding initiated by TDS Metrocom, LLC ("TDS").

## I. INTRODUCTION

On September 12, 2003, TDS filed a Complaint contending that SBC Illinois' termination liability practices were "unjust and unreasonable" under Section 9-250 of the Public Utilities Act and "anticompetitive" under Section 13-514 of the Act. Specifically, TDS objects to SBC Illinois' policy of requiring business customers subscribing to service under a term agreement to pay a charge in the event of early termination based on a percentage of the customer's remaining obligation under the contract or tariffed rate plan. TDS asks the Commission to declare such provisions unlawful and require SBC Illinois to change its tariffs and contracts to utilize the "give-back-the-unearned-discount" approach which TDS uses and that the Commission approved in its *Ascent Order* for the ValueLink services. *Order on Rehearing in Docket No. 00-0024*, February 20, 2002 at 35-37 ("*Ascent Order*").

In fact, SBC Illinois' current termination liability policies are reasonable and are not anticompetitive. The Company's policies are fully consistent with contract law and relevant economic principles. The marketplace for business services in Illinois is competitive as a matter of law and fact. SBC Illinois' general approach to termination liabilities is followed by virtually all other carriers and the percentage amounts that the Company charges are generally lower than those charged by its competitors. The alternative approach recommended by TDS is not more favorable to customers or competition. Accordingly, there is no basis for requiring SBC Illinois – or any other carrier – to use the TDS approach. The marketplace can and will regulate carriers' termination liability policies and the Commission should allow it to do so.

It is well-established that the complainant bears the burden of proving its case before the Commission. *See, e.g., Champaign County Telephone Co. v. Illinois Commerce Comm'n*, 37 Ill. 312, 321 (1967); *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607, 616-17 (1958). TDS failed to meet its burden in this case and its Complaint should be denied.

## II. TDS' COMPLAINT

As indicated above, TDS asks that this Commission declare SBC Illinois' termination liability policies unlawful. SBC Illinois' contracts and tariffed term plans today require customers terminating prior to the specified end date of the agreement to pay a charge based on a percentage of what remains on the contract. SBC Illinois refers to this approach as a "forward-looking" termination liability. SBC Ill. Ex. 1.0 (Gillespie Direct) at 9-10. The amount of the percentage varies by product category and ranges from 25% to 50%. *Id.* at 10-11. Prior to the filing of TDS' complaint, the Company's tariffs and contracts contained termination liabilities that varied widely by product and service: some were "forward-looking" (i.e., the liability was based on a percentage of what was left on the contract), some were "backwards looking" (i.e., the liability was based on the savings the customer achieved for the contract period already completed) and the size of the liability differed widely. *Id.* at 9-10. These differences did not reflect any economic or other differences between the products and services, but rather the accumulation of individual product managers' decisions over a long period of time. *Id.* at 16. Therefore, SBC Illinois substantially revised its policies early in the proceeding. These modified policies apply to all products and services offered under term agreements (whether tariffs or contracts), and to both new and existing customers.[1] The only exception will be the ValueLink services subject to the *Ascent Order*, which will continue to be treated in a manner consistent with that *Order*. *Id.* at 12. These new policies were implemented in March and are now fully effective in SBC Illinois' tariffs and contracts being entered into on a forward-looking basis. *Id.* at 14.

TDS contends that both SBC Illinois' original policies and its revised policies violate Sections 9-250 and 13-514 of the Act. *Complaint* at ¶¶ 7, 8, 40; TDS Ex. 1.0 (Loch Direct) at 18. TDS argues that these policies make it difficult for CLECs to compete for customers under term agreements with SBC Illinois because the charges associated with early termination are high and, therefore, have the effect of tying up customers that would otherwise be good marketing prospects. *Id.* at 5-6. TDS further argues that SBC Illinois' termination charges are not reasonably related to the losses that result from early termination. *Id.* at 7-8. TDS also contends that the Commission has already determined a reasonable approach to termination liabilities in the *Ascent Order* and that it should be applied to all of SBC Illinois' products and services offered under term agreements. *Id.* at 8-9.

TDS, therefore, requests that the Commission impose on SBC Illinois the "give-back-the-unearned-discount" methodology that TDS uses in its term agreements and that the Commission

[1] Customers who entered into term agreements prior to the effective date of the new tariffs and policies will be charged the *lesser* of the early termination liability that applies under their existing agreement and the amount that would result from the new policy. SBC Ill. Ex. 1.0 (Gillespie Direct) at 10.

adopted in the *Ascent Order*. That is, the customer must pay back to SBC Illinois any unearned discounts it received over the term of the agreement that it completed, including any waived non-recurring charges. For example, assume that a customer enters into a 5-year agreement for Centrex service and breaches in month 37 (i.e. just after completing 3 of the 5 years). Since the customer had been paying the low 5-year rates, but only completed a 3-year term (for which separate rates are offered), the total charges to the customer in this example would be recalculated based on 3-year rates and the customer would owe SBC Illinois the difference between what it paid and what it should have paid over that 37-month period.[2] TDS Ex. 1.0 (Loch Direct) at 8-9.

TDS is wrong on both the facts and the law and its Complaint should be denied.

## III. APPLICABILITY OF THE *ASCENT ORDER*

TDS has been consistently ambiguous throughout the proceeding as to whether it believes that the *Ascent Order* today applies to all products and services offered by SBC Illinois under term agreements or whether it is asking that the Commission establish a new policy that is modeled on the *Ascent Order*. For example, TDS stated as follows in its Complaint:

> "SBC Illinois' continued use of termination charge provisions such as those in the Customer A Services Contract, the Customer B Services Contract and the Customer A Centrex Contract, and minimum annual revenue commitment provisions such as those in the Customer C Services Contract, *violates the spirit if not the letter of the Commission's conclusions and directives in the ASCENT case*. SBC Illinois may have implemented the Commission's conclusions and directives in its Order in the *ASCENT* case in an extremely narrow and literal way by only changing its termination charge provisions in the specific tariffs and contracts complained of by the complainant in the *ASCENT* case (i.e., "ValueLink" service packages) . . ." *Complaint* at ¶ 39 (emphasis added).

[2] Although TDS' proposal is similar to what the Commission ordered in the *Ascent* case, it is not identical. In the *Ascent Order*, the Commission required SBC Illinois to change its ValueLink tariffs based on a "give-back-the-unearned-discount" methodology *and* imposed a one-year cap on the amount of the unearned discount which SBC Illinois was permitted to recoup. *Ascent Order* at 28, 35. TDS does not cap its termination liabilities in this fashion and is not proposing a one-year cap in this proceeding. SBC Ill. Ex. 1.0 (Gillespie Direct) at 39-40, Sch. BG-7.

There is, in fact, no ambiguity in this regard. The *Ascent Order* only applies to a small group of services and SBC Illinois is in full compliance with that *Order*.

By way of background, on January 11, 2000, the Association of Communication Enterprises ("ASCENT"), a trade association representing resellers, filed a Complaint charging that the termination liabilities used by SBC Illinois in certain term plans were unreasonable and anticompetitive. The tariffs at issue were specifically enumerated in the Complaint and identified in the *Ascent Order* (*i.e.,* ValueLink Extra, ValueLink Extra Select, ValueLink Illinois-Option F, ValueLink Illinois Option F Preferred, Enhanced Ameritech ValueLink Plus, CompleteLink and the Straight Rate plans). *Ascent Order* at 1, n. 1. At the time that the ASCENT complaint was filed, SBC Illinois' standard practice was to charge 100% of the amount remaining on the agreement for the ValueLink services. The *Ascent Order's* Findings and Ordering Paragraphs were, thus, appropriately directed to *those services* and the *tariffs* under which those services were offered. For example, Finding (9) provides as follows:

> "Ameritech should revise the *tariffed calling plans described in Finding (5)* to provide for termination charges calculated by subtracting the discounted charges the customer actually incurred during its term of service from the charges the customer should have incurred, based on its actual term of service, under the pertinent tariffed calling plan; further, Ameritech should be prohibited from including earned discounts, as described in this Order, in such termination charges; and further, Ameritech should be prohibited from including in such termination charges any unearned discounts associated with ValueLink services provided more than 12 months before service termination." *Ascent Order* at 35 (emphasis added).

Finding (5) (referenced in Finding (9)) listed the ValueLink services referred to above.

Similarly, the relevant Ordering Paragraph provides as follows:

> "IT IS THEREFORE ORDERED that within 30 days of the date of this Order, Ameritech shall revise the *tariffs for the services described in Finding (5)* to incorporate the termination charges described in Finding (9)." *Ascent Order* at 37 (emphasis added).

SBC Illinois made the required modifications in these tariffs in a timely fashion and has been calculating termination liabilities in accordance with the *Ascent Order* since then.[3] SBC Ill. Ex. 1.0 (Gillespie Direct) at 8. Staff agrees that SBC Illinois is in full compliance with the *Ascent Order*. Staff Ex. 1.0 (Omoniyi Direct) at 11.

Furthermore, the Commission's decision that SBC Illinois' then applicable termination liability policy for the ValueLink tariffs was unreasonable was based on the specific facts of that case. The Commission noted, for example, that the initial ValueLink tariffs had taken effect in 1996, literally within days or weeks of the implementation of intraMSA equal access, and that competition was nascent for those services:

> "Sustainable competition for Band C calls could not have developed in a single day or in three weeks. Rather, these facts indicate that the termination penalties associated with the forgoing ValueLink services were introduced to lock in customers and thereby thwart the emergence of competition." *Ascent Order* at 17.

With respect to the 100% termination liability policy, the Commission concluded as follows:

> "…it inherently exceeds actual damages. Whatever Ameritech's actual damages may be when a ValueLink agreement is terminated, it is something less than expected revenues, because the subject services cost something to provide." *Id.*

As will be demonstrated in more detail below, the circumstances surrounding the TDS Complaint are entirely different. It is now *2004*. Many of the services at issue in this Complaint (e.g., Centrex and transport products) have been competitive for years, substantially longer than usage-based products. Even for usage, the marketplace has become very competitive since 1996. With respect to the size of the termination liabilities charged, SBC Illinois eliminated the 100%

[3] Although the *Ascent Order* did not require SBC Illinois to make changes in *other* usage-based products or in *non-tariffed* offerings, SBC Illinois did so anyway. The 50% early termination liability that SBC Illinois filed during the *Ascent* proceeding was initially used for non-ValueLink usage-based tariffs and contracts that included the ValueLink family of services. Subsequently, SBC Illinois adopted a 35% policy for all new usage-based tariffs. SBC Ill. Ex. 1.0 (Gillespie Direct) at 8.

policy in 2002 following the *Ascent Order* and has since further revised its termination liability policies downwards so that it now charges between 25% and 50% of what remains on the contract. This is a far cry from the level that the Commission found objectionable in 2002.

Accordingly, there is no basis for TDS' suggestion that the *Ascent Order* may already require the result it requests in its Complaint. Instead, TDS must demonstrate that the relief it requests is legally required based on *current* market conditions and SBC Illinois' *current* practices. This it has failed to do.

## IV. TDS' TERMINATION LIABILITY POLICY SHOULD NOT BE IMPOSED ON SBC ILLINOIS

### A. SBC ILLINOIS' TERMINATION LIABILITY POLICIES ARE REASONABLE

TDS contends that SBC Illinois' termination liability policies are unreasonable and must be changed. The basis for its claim essentially reduces to the contention that the amounts customers are required to pay if they terminate their agreement early are "large in the absolute and tend to overwhelm any price savings or other benefits the customer would otherwise realize by switching from SBC Illinois to TDS Metrocom." TDS Ex. 1.0 (Loch Direct) at 6. TDS further argues that SBC Illinois penalizes the customer by "extracting an amount in excess of any benefit the customer received by virtue of the discounts under the agreement." *Id.*

TDS is mistaken as to both the relevant legal standard and economic policy considerations. Under general contract law, an early termination liability is a substitute for calculating damages at the point in time when the customer actually breaches the agreement. Thus, these kinds of provisions estimate the economic harm that a contracting party would suffer from early breach. In the *Ascent* case, SBC Illinois took the position that, under contract law, it is entitled to "the revenues the Company loses, less any avoidable costs, plus any incremental expenses it incurs." *Ascent Order* at 23. There was general agreement in that proceeding that this was an appropriate standard. Even the Complainant conceded that SBC Illinois would be entitled to "lost profits," which it defined as "net profits," citing *Sterling Freight Lines, Inc. v. Prairie Material Sales, Inc.*, 285 Ill. App. 3d 914 (1997) and *Getshow v. Commonwealth Edison Co.*, 111 Ill. App. 3d 522 (1982). *Id.* at 23-24. The Commission rejected SBC Illinois' 100% termination liability policy because it did not limit SBC Illinois' recovery of damages to lost profits, *not* because it was based on a percentage of what remained under the contract:

> "The termination liability penalties in the ValueLink tariffs and contracts obligate the terminating party to pay for all minimum usage required over the remaining life of the agreement. *This is inconsistent with Ameritech's own formula for determining actual damages, since avoidable costs are not subtracted*. Similarly, under the principles advanced by ASCENT, the ValueLink penalties put Ameritech 'in a better position' than if no termination had occurred, because Ameritech recovers the cost of providing undelivered services. Ameritech thus receives more than its gross profits, let alone its net profits. Moreover, direct incremental expenses made necessary by early termination (if any) are not expressly identified or quantified at all. Therefore, we find that the ValueLink termination penalties are not designed to recover actual damages under either Ameritech's formula or ASCENT's principles." *Id.* at 24 (emphasis added).

SBC Illinois' current termination liabilities are consistent with the principles set out in the *Ascent Order.* The Company conducted a through analysis of all of the products and services it offers under term agreements, identifying both the revenues received and the costs avoided. SBC Illinois subtracted its avoidable (LRSIC) costs from its revenues for each product and service and ensured that the percentage termination liability applicable to each family of products and services fell within the range produced by this analysis. Although SBC Illinois would be entitled under the *Ascent Order* to recover additional "incremental expenses" it incurs as a result of contract termination, it elected not to do so. All termination liabilities in place today are either at or below the "lost profit" standard. SBC Ill. Ex. 1.0 (Gillespie Direct) at 20-21; SBC Ill. Ex. 3.0 (Flitsch Direct). Notably, TDS nowhere challenged SBC Illinois' service cost analysis or the fact that its termination liabilities fall well within the standard set in the *Ascent Order*.

In addition, the absolute amounts are reasonable. As noted above, SBC Illinois' termination liabilities are based on a percentage of the monthly charges remaining in the customer's term commitment. SBC Illinois' products and services are placed into three groups: (1) Centrex; (2) Usage (including network access lines); and (3) Transport Services/Other. The percentage termination liabilities that apply to each group are as follows:

- Centrex--25% of the amount remaining on the term agreement.
- Usage (including network access lines)--35% of the amount remaining on the term agreement.
- Transport Services/Other--50% of the amount remaining on the term agreement.

These amounts are substantially lower than the 100% level at issue in the *Ascent* case. This policy generally represents either a reduction in or a continuation of the *status quo* relative to the termination liabilities in use of the time that TDS filed its complaint.[4]

This approach is consistent with basic market and economic principles. SBC Illinois presented the testimony of Dr. Alan S. Frankel, an experienced economist in the area of antitrust and competition policy analysis. SBC Ill. Ex. 2.0 (Frankel Direct) at 1-2. As Dr. Frankel explained, termination liability provisions are a common component of term agreements across many industries. In the event of litigation resulting from a breach by a buyer, it would be standard practice in those industries to analyze and compute the supplier's expected costs and revenues over the remaining term of the contract. According to Dr. Frankel, a measure of liquidated damages resulting from breach of contract would typically be the supplier's expected

[4] For Transport/Other Services the impact will vary by product and service. That is, replacing backwards-looking termination liabilities with forward-looking termination liabilities will produce higher amounts early in the contract period and lower amounts later in the contract period. SBC Ill. Ex. 1.0 (Gillespie Direct) at 11.

lost profits. Dr. Frankel further stated that SBC Illinois' policy results in a conservative approximation of damages, because the Company subtracts avoided costs (LRSIC) from the revenues otherwise due under the contract. It is conservative in his view because, in the short run, a breach typically leaves SBC Illinois with unused capacity it had expected to be generating revenue. Dr. Frankel testified that, if SBC Illinois maintains the same capacity with or without the early termination, then its lost profits would equal the total lost revenue – not just its revenues less costs. SBC Ill. Ex. 2.0 (Frankel Direct) at 26-27.

SBC Illinois' termination liability policies are also consistent with the practices of other carriers in Illinois. All carriers incorporate termination liabilities into their term plans and virtually all of them use a "forward-looking" approach comparable to that used by SBC Illinois (e.g., McLeodUSA, XO, Focal, AT&T, MCI, Allegiance, and Mpower). In fact, TDS is the *only* CLEC that uses the "give-back-the-unearned-discount" approach. Moreover, SBC Illinois' percentage amounts are either comparable to or much *lower* than what its competitors charge. SBC Ill. Ex. 1.0 (Gillespie Direct) at 25-26. For example, many CLECs today charge between 75% and 100% of what remains on the contract for local service, Centrex and transport products. SBC Ill. Ex. 1.0 (Gillespie Direct), Sch. BG-3. Nowhere did TDS dispute the fact that SBC Illinois' charges are generally much lower than those of its competitors.

TDS has acknowledged that the issues raised by its Complaint have been partially addressed by these lower termination charges. As its lead witness stated in his rebuttal testimony:

> "TDS Metrocom's preference would still be for the Commission to require SBC to implement the form of termination charge provision that it ordered in the ASCENT case (Docket 00-0024), which I described in my direct testimony. Having said that, I will acknowledge, as I did in Answer 29 of my direct testimony, that SBC's revised termination liability policies with the reduced percentages of remaining contract plan or tariff revenues are an improvement in that they produce a lower termination charge

> amount than did previous termination liability provisions that required the customer to pay 75% or 100% of remaining revenue under the contract or tariff plan as a termination charge. However, the termination charges produced by SBC's new termination liability provisions are still too high and will continue, in my judgment, to significantly if not completely limit any switching by business customers taking service from SBC under term contracts and multi-year tariff plans." TDS Ex. 1.5 (Loch Rebuttal) at 2-3.

Although TDS continues to claim that SBC Illinois' termination charges are "too high," this statement is devoid of factual context or analytical basis. As SBC Illinois explained, the relevant standard is whether these charges reasonably reflect the Company's economic loss – not whether business customers can shift providers at little or no cost. SBC Ill. Ex. 1.0 (Gillespie Direct) at 36-37. These customers have entered into contractual arrangements and, generally speaking, should be expected to complete their commitments before selecting another vendor. SBC Illinois has demonstrated that its termination liabilities are reasonably related to its economic losses and they should not be subject to regulatory intervention just because TDS would like to obtain SBC Illinois' customers earlier in their contract periods.

As an alternative, TDS suggests for the first time in its rebuttal testimony that the Commission cap SBC Illinois' termination liabilities at 25%. TDS Ex. 1.5 (Loch Rebuttal) at 8. There is no evidence to support this proposal, other than TDS' apparent preference that termination charges be lower rather than higher. SBC Illinois' existing 25%/35%/50% policies are fully consistent with its financial analyses and TDS does not contend otherwise. A 25% cap on termination liabilities is substantially lower than what any other carrier charges in the marketplace and TDS does not contend otherwise. Finally, SBC Illinois' current policies already properly reflect the *Ascent Order* standards. There is simply no basis for requiring a further, unilateral reduction.

### B. SBC ILLINOIS' TERMINATION LIABILITY POLICIES ARE NOT ANTICOMPETITIVE

TDS claims that SBC Illinois' termination liability policies are anticompetitive and have the effect of removing customers under term agreements from the competitive marketplace. TDS Ex. 1.0 (Loch Direct) at 5-6, 8. In support of its market foreclosure theory, TDS' evidence consisted primarily of three customers under term agreements with SBC Illinois who elected not to breach those agreements early to take service from TDS. TDS Ex. 2.0 (Stearns Direct).

TDS' customer examples do not constitute a showing that SBC Illinois' term agreements have the effect of locking up the marketplace. All parties to this proceeding agree that term agreements are appropriate, confer benefits on customers and are pro-competitive. TDS Ex. 1.0 (Loch Direct) at 7-8; SBC Ill. Ex. 2.0 (Frankel Direct) at 8-13; Staff Ex. 2.0 (Koch Direct) at 5. Termination liabilities are part and parcel of term agreements. Carriers offer customers discounted rates in return for a commitment to take service over a specified period of time. In fact, the entire point of entering into a contract with a stated duration is to provide mutual assurance to both parties that the relationship will continue for that period of time and to deter early termination of the business relationship. SBC Ill. Ex. 2.0 (Frankel Direct) at 14. Without that contractual protection, carriers would have no incentive to offer discounted rates. *Id.*

As Dr. Frankel explained, there is a fundamental economic distinction between competition for an individual customer and competition in the market. It is often the case that competition is intense in a market even though particular customers under contract cannot easily switch suppliers. Commercial and residential rental real estate markets, for example, are characterized by term contracts and significant contract or transaction costs for early termination, yet remain intensely competitive due to the constant turnover of tenants and expiration of existing leases, in addition to sublease rights or other options for early termination. SBC Ill. Ex.

2.0 (Frankel Direct) at 11-12, 16. Therefore, the mere fact that individual customers may be deterred from changing providers while still under contract does not mean that they are foreclosed from competition.

The market for telecommunications service is no different. To begin with, there is competition between SBC Illinois, TDS, and other CLECs to recruit customers to enter into term contracts in the first instance. As a contract nears expiration, another round of competition can occur for that customer without requiring any payment of termination liabilities. There is, in fact, a steady supply of customers whose contracts are nearing expiration and are logical recruiting targets for both the incumbent carrier and competitors. In addition, at any time, there are numerous SBC Illinois customers obtaining service on a month-to-month basis not constrained by any term commitment from switching suppliers at will. Competitors can market their services even to customers under contract. While this tends to occur more as contracts near expiration, CLECs can also assume the remaining term of existing SBC Illinois contracts. Although either the customer or a CLEC can pay the termination charge to switch the customer's service prior to the end of the original contract term, another alternative would be for a CLEC to assume the remainder of an existing SBC Illinois contract prior to migrating the customer to the CLEC's own facilities. SBC Ill. Ex. 2.0 (Frankel Direct) at 14-15.

To demonstrate that SBC Illinois' termination liability policies do not have the effect of locking up the local exchange marketplace, Dr. Frankel conducted an extensive analysis of SBC Illinois' term agreements. A significant percentage of SBC Illinois' business customers are not on term agreements at all. Moreover, a steady portion of the business customer base that is currently under term agreements regularly rolls off those contracts during any given time period. SBC Ill. Ex. 2.0 (Frankel Direct) at 18-19. Generally speaking, SBC Illinois' term agreements are for three years or less. SBC Ill. Ex. 1.0 (Gillespie Direct) at 33. Based on Dr. Frankel's analysis for 2003, 75 percent of usage-based customers, 77 percent of data/transport customers, and 81 percent of Centrex/PBX customers were either already free from SBC Illinois contracts, could terminate SBC Illinois service at any time without incurring any fee, or would be free to do so before the end of 2004. Another approximately eight percent are operating under SBC Illinois contracts terminating in 2005. According to Dr. Frankel, even if SBC Illinois' term contracts were ironclad and permitted no early termination under any circumstances – which they are not – they would not constitute any sort of economic "lock-up" or restriction of competition in the marketplace: SBC Illinois simply has far too few customers committed to long-run contracts at any point in time. Moreover, these contracts *are* assumable and they *do* provide for early termination. In Dr. Frankel's expert opinion, there is absolutely no "lock-up" of the market from an economic perspective. SBC Ill. Ex. 2.0 (Frankel Direct) at 16, 21-22.[5]

TDS had effectively no response to this analysis. It simply complained that it did not have the resources to hire its own economist. TDS Ex. 1.5 (Loch Rebuttal) at 1-2. This is not evidence. Moreover, the analysis presented by Dr. Frankel is not overly complex and does not require expert economic training to address. SBC Illinois' evidence in this regard is unrebutted and TDS' vague claims of foreclosure based on anecdotal evidence should be rejected.

### C. THE MARKETPLACE FOR THE SERVICES AT ISSUE IS COMPETITIVE

The Commission's *Ascent Order*, and the relief granted therein, was heavily influenced by marketplace conditions at the time the ValueLink services were introduced. As part of its

[5] According to Dr. Frankel, there is no universally applicable share of customers under contract that constitutes a safe harbor. However, Dr. Frankel testified that it can generally be assumed that in a market in which only 12 to 25 percent (and even fewer, if one includes contracts expiring after 2005) of customers operate under long term contracts with the leading provider, those contracts *cannot* be anticompetitive. In this case, moreover, SBC Illinois' market share is declining, a further indication that the contracts create no competitive foreclosure in the marketplace. *Id*. at 22; SBC Ill. Ex. 4.0 (Longua Direct) at 9.

analysis determining whether the ValueLink termination liabilities should be changed, the Commission evaluated whether customers had assumed those penalties in a “genuinely voluntary fashion” – i.e., whether customers had had “meaningful choice” and “sufficient (if unequal) bargaining power.” *Ascent Order* at 22. In concluding that customers had not had sufficient choice with respect to *those offerings*, the Commission relied *inter alia* on the following facts:

- Equal access for Band C usage was first implemented on April 7, 1996.
- The ValueLink Illinois tariff became effective on the following day, and the Enhanced ValueLink tariff became effective three weeks later.
- The availability of competitive alternatives for Band C usage, network access lines and local usage had not been established by the parties, leading to the Commission’s conclusion that none existed in 1996 or when the other tariffs were introduced. *Id.*

The record in the instant proceeding reflects entirely different facts.

There is now a substantial level of competition in Illinois for business customers generally and across the entire range of business services. Approximately 79 CLECs provide service in SBC Illinois’ local service territory, approximately 56 of which provide service exclusively or predominately over their own facilities or over UNEs leased from SBC Illinois. SBC Ill. Ex. 4.0 (Longua Direct) at 3. Moreover, not all competitors are regulated carriers and the choices available to customers are not just between like-for-like products, but for substitute products as well. For example, the principle competitive alternative to network-based Centrex is an unregulated PBX. SBC Ill. Ex. 1.0 (Gillespie Direct) at 28.

SBC Illinois supplied its current market shares for the products and services at issue in this proceeding.[6] CLECs today serve approximately 35% of the business lines in SBC Illinois’

[6] The absolute values of SBC Illinois’ market shares for services other than usage are not provided in this Initial Brief because the information is proprietary. They are contained in SBC Illinois’ testimony. SBC Ill. Ex. 1.0 (Gillespie Direct) at 28-29.

serving territory. SBC Ill. Ex. 4.0 (Longua Direct) at 5. In most cases, the carrier providing the network access line (i.e. the "dial tone provider") also provides local calling services. Therefore, the 35% figure is a reasonable proxy for the CLECs' share of local calling on a per-line basis.[7] Because intraMSA toll calls can be separately presubscribed to IXCs providing long distance service (and who are *not* the dial tone provider) and the IXCs have competed for toll calls for a long time, the combined CLEC/IXC share of the intraMSA toll market is higher than the CLEC-only share of local calling services. The CLECs' share of the transport service markets is substantially greater than for usage. Finally, SBC Illinois serves only a very small percentage of the premises equipment market: Centrex customers account for only 20% of the entire market, with PBX solutions serving the remaining 80%, and CLECs serve part of that 20%. SBC Ill. Ex. 1.0 (Gillespie Direct) at 28-29.

Nor is this competition a recent development. The CLEC market share for business usage and network access lines has grown from 20% in the 3rd quarter of 2000, to 35% in the 3rd quarter of 2003. SBC Ill. Ex. 4.0 (Longua Direct) at 9. Competition for intraMSA toll services dates back to the late 1980s and early 1990s, well before the advent of the CLECs. Even customers who signed ValueLink agreements in the 1996-98 time frame have seen those agreements roll over at least once and maybe twice, with the opportunity to make another competitive choice at each juncture. SBC Ill. Ex. 1.0 (Gillespie Direct) at 30, 32. SBC Illinois' share of the transport marketplace started to decline significantly in the mid-1990's, well before the CLECs began to offer local exchange service on a broad scale and it has continued to decline. SBC Ill. Ex. 1.0 (Gillespie Direct) at 31. Competition in the premises systems marketplace dates all the way back to the 1970's. Even by divestiture in 1984, PBX vendors had more than 50%

[7] Since the CLECs typically target larger customers or customers with heavy calling needs, their share on a revenue basis would be even higher. SBC Ill. Ex. 1.0 (Gillespie Direct) at 29.

of this market. *Id.* at 29-30. Although the competitive *network* provision of Centrex service by CLECs is a more recent development, in 1995 the Commission rejected a CLEC proposal that a "fresh look" requirement be imposed on SBC Illinois' term Centrex agreements. *At that time* the Commission acknowledged that Centrex service was fully competitive and that customers had had ample alternatives when entering into those agreements. *Order in Docket No. 94-0096/94-0117/94-0146/94-0301, Consol.*, dated April 7, 1995 at 123. Centrex service is certainly not less competitive today.

Moreover, policy makers now agree that SBC Illinois' business services are competitive. In 2001, the Illinois General Assembly approved legislation that classified all of SBC Illinois' business services competitive as a matter of law. The Illinois Commerce Commission on May 13, 2003, and the FCC on October 15, 2003, concluded that SBC Illinois' local markets were "irreversibly open" when they granted SBC Illinois' 271 application to provide long distance services. SBC Ill. Ex. 1.0 (Gillespie Direct) at 32-33. This was not the case during the period covered by the *Ascent Order*.

In short, business customers have, and have had for a considerable period of time, competitive alternatives for all of the products at issue in this proceeding. They can take service from a wide variety of vendors and choose between an equally wide variety of prices, terms (including early termination policies) and service arrangements. If customers do not like SBC Illinois' offerings on any of these scores, they can take service from another provider. *Id.* These facts present a radically different policy framework in which to address the issues raised by TDS than existed during the *Ascent* proceeding. There is no basis *today* for the Commission to interfere in voluntary choices made by business customers.

### D. TDS' PROPOSAL IS NOT SUPERIOR TO THE APPROACH USED BY SBC ILLINOIS

Critical to TDS' Complaint is the assumption that *its* approach to termination liabilities is superior from a customer and competitive perspective. TDS is simply wrong. First, its "give-back-the-unearned-discount" approach does not produce lower absolute termination liabilities. SBC Illinois compared the financial impact of its approach to TDS' approach in typical Centrex and DS-1 term agreements. The TDS approach produced *higher* absolute termination liabilities than SBC Illinois' in *over 60%* of the months in each contract term. SBC Ill. Ex. 2.1 (Frankel Rebuttal) at 10-11; SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 12-13. The only real difference between the two is that SBC Illinois' forward-looking approach produces higher termination liabilities in the early part of the contract period, while TDS' "give-back-the-unearned-discount" approach produces higher termination liabilities in the latter part of the contract period. From a strictly financial perspective, this is a "six of one, half a dozen of another" proposition. There is absolutely no policy basis for imposing TDS' approach on SBC Illinois when there is no material financial difference between the two.

TDS had no response to these awkward (for it) facts, other than to suggest that the Commission might want to impose the *Ascent Order's* one-year cap on termination liabilities calculated under the "give-back-the-unearned-discount" approach. TDS Ex. 1.5 (Loch Rebuttal) at 6-7. This suggestion demonstrates the poverty of TDS' position. TDS modeled its requested relief on *its* approach to termination liabilities and *it* does not cap these payments at one year. TDS clearly stated at the outset of the proceeding that it was *not* seeking a one-year cap. If the Commission were to follow TDS' latest suggestion, it would be imposing a policy on SBC Illinois that is utilized by *no carrier* in the marketplace, not even *the Complainant*. There is no possible argument that SBC Illinois would be recovering its economic losses under this approach, even under TDS' theory of how to calculate such losses, and all of the uneconomic disincentives of the TDS approach described below would be magnified several times over. It is far too late in the game for TDS to be changing conceptual "horses."

TDS cannot argue that its "give-back-the-unearned-discount" approach is standard in the marketplace. It is *not*. TDS is the *only* carrier among the major competitors in Illinois to use this approach. All other major competitors use a "forward-looking" percentage of what remains on the contract. It would be more than a little strange for the Commission to impose on SBC Illinois, for use in *all* of its term plans for *all* of its products and services, an approach to termination liabilities that almost no competitive carrier uses. SBC Ill. Ex. 1.0 (Gillespie Direct) at 40.

TDS' approach also does not comport with common notions of contractual obligation and equity. Generally speaking, customers expect a termination liability to decline over the period of a contract. That is, the more of the contract that the customer completes, the lower the termination liability should be. This is how SBC Illinois' approach works. TDS' approach works in the opposite direction. Under its methodology, the early termination liability is lowest if the customer breaches early in the term of the contract. It then rises and falls as customers approach and pass the 1, 3 and 5-year milestones when different discount levels are satisfied. However, a customer will always pay a higher early termination liability towards the end of the agreement under TDS' approach than under SBC Illinois'. SBC Ill. Ex. 1.0 (Gillespie Direct) at 40-41. This produces a counterintuitive, roller coaster effect for customers.[8] As Dr. Frankel explained, back-ending the termination liability in this manner is actually anticompetitive,

[8] For example, a customer may pay more in term liabilities if they leaves in month 33 of a 60-month contract than if they leave in month 15 under the TDS approach. Even more illogical is that a customer could pay more in termination liabilities if it leaves in month 59 of a 60-month contract than if it leaves in month 2. SBC Ill. Ex. 1.0 (Gillespie Direct) at 40-41, Sch. BG-8.

because it is at the end of a contract term that customers are most likely to be considering competitive alternatives and competitors are most likely to be wooing customers. SBC Ill. Ex. 2.0 (Frankel Direct) at 30; SBC Ill. Ex. 2.1 (Frankel Rebuttal) at 10. The Commission should not be imposing a termination liability policy on SBC Illinois that is actually anticompetitive.

TDS' response to this argument is to claim that termination liabilities *should be* low in the early part of the contract. Mr. Loch testified as follows in his rebuttal testimony:

> "It is in the early months of a long-term contract when the potential anticompetitive impacts of a termination charge in terms of discouraging the customer from considering other suppliers may be most pronounced, because the large termination charge at that point effectively locks up the customer with SBC for two or more years into the future. In contrast, in the last few months of a customer's term contract, a potential new carrier may not be interested in trying to get the customer to terminate the contract and switch regardless of the termination charge – the new carrier can simply wait the relatively few remaining months until the existing contract expires, or even try to sign the customer to a new contract to go into effect when the customer's old contract expires." TDS Ex. 1.5 (Loch Rebuttal) at 5-6.

This simply does not comport with normal contractual expectations nor is it the basis for a finding of *unlawfulness*. The carrier has a reasonable expectation that, having just expended considerable marketing time and resources to woo the customer, their relationship will be stable for some meaningful period of time. Similarly, the customer would expect to be required to fulfill its contractual obligation for some meaningful period of time. Most competitors would focus their marketing efforts on customers as their contracts expire. An appropriate termination liability policy cannot be defined solely by the interests of *one* competitor in persuading customers to breach their contractual obligations early.

TDS' approach also does not reflect a reasonable balancing of the risks associated with long-term agreements. Under the TDS approach, customers are automatically given the best possible "deal" in terms of the rates the customer pays. There is no scenario in which a customer would be worse off entering into a term plan with SBC Illinois than subscribing to service on a month-to-month basis. Normally, there is risk on both sides when parties enter into long-term agreements and this sharing of the risks is what induces both parties to do so. Sophisticated customers (or even unsophisticated customers) would quickly figure out that, under TDS' approach, term agreements would be risk-free propositions. Customers could commit to the longest possible term offered by SBC Illinois, regardless how long they actually intended to stay: since the customer would obtain the lowest available rates and would only have to pay back the unearned discount if it breached the agreement, it is no worse off financially than if it makes a commitment based on a realistic assessment of its future plans and needs.[9] SBC Ill. Ex. 1.0 (Gillespie Direct) at 41-42. Customers should not be encouraged to game the system in this manner. Moreover, having customers enter into agreements that are longer than they would otherwise elect could have the perverse effect of making customers less available, not more available, to competitors. SBC Ill. Ex. 2.0 (Frankel Direct) at 29.

Furthermore, TDS' approach is not workable where SBC Illinois has to make customer-specific investments in facilities. First, it would make construction of specialized networks unworkable from both SBC Illinois' perspective and the customer's. If a customer can terminate a contract essentially at will (subject only to having to give back unearned savings), SBC Illinois cannot make any assumption as to the likely duration of the arrangement. Given the large amounts of capital typically required to build specialized systems, prudence would demand that all sunk costs be recovered quickly at the front end of the contract. Most customers do not want to (or cannot) absorb the up-front costs of a special construction project in a one-time

[9] It also does not appear that TDS charges interest on the amounts paid back. As a result, TDS is effectively providing an interest-free loan to the customer for the difference between the rates the customer actually pays and the rates the customer should have paid. SBC Illinois does not normally provide its customers with interest-free loans. Business and residence customers, for example, are assessed late payment charges when their bills are not paid on a timely basis. *Id.*

charge, but instead prefer to spread that cost over the term of the agreement as part of their monthly recurring charge. The net result is that the customer would simply not buy the system from SBC Illinois (or at all, if no CLEC wants to undertake the project). No legitimate policy objective would be accomplished by making it effectively impossible for SBC Illinois to meet the needs of its more sophisticated business customers. SBC Ill. Ex. 1.0 (Gillespie Direct) at 42-43. Second, these kinds of networks are not purchased under tariffs that establish alternative rates for alternative term periods—they are individually negotiated. Therefore, there is literally no way to compute a "payback the savings" early termination liability, because there is no rate for the "next lower completed term" for this particular customer. *Id.* TDS had no response whatsoever to this issue.

In short, TDS' approach has serious deficiencies of its own and it should not be the subject of a regulatory mandate.

### E. SBC ILLINOIS SHOULD NOT BE REQUIRED TO CALCULATE TERMINATION LIABILITIES FOR CLECS

In the rebuttal phase of the proceeding, TDS for the first time asked the Commission to require SBC Illinois to calculate termination liabilities for all customers taking service under long-term agreements when requested to do so by a CLEC. TDS Ex. 1.5 (Loch Rebuttal) at 8-9. Finding (10) of the *Ascent Order* imposes this requirement on SBC Illinois, but only for the ValueLink services.

SBC Illinois moved to strike this testimony. It is axiomatic that the Commission may not grant relief which exceeds the scope of the relief requested in the complaint that is before it. *Alton and Southern Railroad et al. v. Illinois Commerce Commission ex rel. Perry Coal Company et al.*, 316 Ill. 625, 629-30 (1925) ("while the Commission should be notified of the complaint which they are required to answer, and although no particular form is prescribed, there must be a statement of the thing which is claimed to be wrong, sufficiently plain to put the carrier upon its defense"); *Peoples Gas, Light and Coke Company v. Illinois Commerce Commission*, 221 Ill.App.3d 1053, 1060 (1991) ("if the ICC were permitted to enter an order that is broader than the written complaint filed in the case then it would be ruling on an issue of which the responding party had no notice and no opportunity to defend or address").

The Administrative Law Judge denied SBC Illinois' Motion, but provided the Company with an opportunity to file responsive testimony. SBC Illinois did so, and admits that this ruling substantially eliminated the prejudicial effect of TDS' conduct. However, SBC Illinois renews its Motion to Strike because of the precedential implications of this ruling. Complainants should not be encouraged to expand the relief they request in the final stages of a proceeding. It is administratively inefficient and contrary to proper administrative procedures. The Commission, its Staff and the carrier are entitled to notice at the outset of the proceeding of the entire scope of the relief sought by the Complainant, so that they can appropriately develop litigation positions, strategy and evidence. The ruling of the Administrative Law Judge encourages complainants to end run orderly processes.

In the event the Commission upholds the Administrative Law Judge's ruling, TDS' proposal should be denied on its merits. Today, under Finding (10) of the *Ascent Order*, SBC Illinois is obligated to calculate the charges that would be due in the event that a ValueLink customer terminates the agreement early. SBC Illinois must perform such calculations within three business days of receipt of the request and must respond to requests from either the customer directly or from a CLEC that has been designated as the customer's agent. This calculation obligation was not premised on a proposal of any of the parties in the *Ascent* case. Rather, the Commission adopted it from an Ohio order, and required such calculations to

". . .obviate the need for future administrative litigation regarding implementation of this order. . ." *Ascent Order* at 29-30.

This requirement should not be expanded to cover all of SBC Illinois' products and services offered under term agreements, as TDS suggests. It was adopted specifically and solely to implement the *Ascent Order*. As SBC Illinois has demonstrated previously, TDS has not made a case that would justify extending the termination liability provisions of the *Ascent Order* to other products and services, much less ancillary requirements such as Finding (10).

On its merits, such a requirement would be unduly burdensome. Because SBC Illinois has not mechanized the process of calculating termination liabilities, every request has to be responded to manually. Determining what products or services are the subject of the request and performing the necessary calculations is generally complicated and the process is more cumbersome and time-consuming when a CLEC is involved than when the Company is dealing directly with the customer.[10] SBC Illinois simply does not have enough managers in the workgroup responsible for calculating termination liabilities to respond to both customer *and* CLEC requests and would have to add personnel if Finding (10) of the *Ascent Order* were expanded to include other products and services. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 5-7. Thus, this requirement is not reasonable.

Contrary to TDS' contention, it *can* compete for customers without obtaining this information directly from SBC Illinois. TDS Ex. 1.5 (Loch Rebuttal) at 9. TDS is ignoring the other source of information available to it: *i.e.*, the customer whose business it is trying to win.

[10] Although some CLECs are sophisticated and knowledgeable, many are not. It is not unusual for a CLEC making a request to have only the sketchiest of information about the customer's service. When there are questions, CLECs usually have to go back to the customer for more information and the requested information is not always accurate or clear when the CLEC recontacts the Company. Finally, CLECs may request multiple iterations based on different possible scenarios. This seems to be the case in situations where the CLEC is just beginning its discussions with the customer. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 5-6.

SBC Illinois provides its customers with copies of all contractual term agreements which the customer enters into as a routine part of the contracting process. Customers taking service pursuant to tariffed term plans can obtain a copy of confirming documentation upon request. The customer can elect to provide copies of the agreements and/or confirming documentation to the CLEC in any negotiations to change service providers. In many instances, these documents would allow CLECs to estimate the liability that would result from early termination themselves. Furthermore, SBC Illinois' practice is to calculate termination liabilities for its customers, regardless of the purpose of the request. Thus, CLECs can obtain termination liability calculations from SBC Illinois through the customer if they so desire. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 8-9.

The expanded obligation proposed by TDS is inappropriate in a competitive marketplace. CLECs ask SBC Illinois to perform these calculations largely because it is easy and costless for them to do so. Since SBC Illinois cannot charge the CLECs for calculations required by the *Ascent* Order, it is more economical for the CLEC to ask SBC Illinois to perform them than to have their own employees spend time doing so. In effect, the CLECs have made SBC Illinois' employees part of their sales staffs. SBC Illinois does not believe that this is an appropriate role for it to play and particularly objects to new obligations that would require it to add headcount, while the CLECs avoid incurring any costs of their own. Furthermore, a small number of CLECs are responsible for the vast majority of CLEC requests for calculation of termination liabilities. Since other CLECs also compete for SBC Illinois' customers under term agreements, these CLECs must perform more of the calculations "in house" and/or work through the customers directly. Nothing prevents TDS from taking the same approach. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 12.

TDS' proposal is also inconsistent with the general operation of the marketplace. CLECs do not routinely perform these calculations for other carriers (whether SBC Illinois or another CLEC) that are trying to persuade their customers to switch service providers prior to the end of a term agreement. For example, when SBC Illinois' sales team is competing for a customer under a term agreement with a CLEC, it works with the customer to determine what agreements they have entered into and SBC Illinois calculates the potential termination liability itself. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 12-13.

Finally, no other state commission in the SBC Midwest region imposes such a requirement on carriers operating in that state. Although the Finding (10) requirement was modeled on an Ohio Commission order, it is no longer operative. It was a one-time event when competition for local exchange service was first authorized in Ohio and it expired for SBC Ohio years ago. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 13-14. In other words, the Ohio requirement, like the *Ascent* Order requirement, was viewed as necessary when competition was first taking hold. With the maturation of the competitive marketplace since then, there was and is no reason to continue these obligations. Accordingly, there is no basis for TDS' proposal and it should be rejected.

## V. STAFF'S RULEMAKING PROPOSAL SHOULD NOT BE ADOPTED

Staff's principal recommendation is that the Commission conduct a rulemaking proceeding to establish consistent termination liability policies for the entire industry. Staff Ex. 1.0 (Omoniyi Direct) at 15; Staff Ex. 2.0 (Koch Direct) at 13-14. Staff proposed a rulemaking proceeding because it believes that there are offsetting policy concerns. Staff recognized that term agreements produce benefits for both carriers and customers and that termination liabilities are necessary. As between SBC Illinois' and TDS' approaches, Staff generally favored TDS', based on the assumption that it generally produced lower termination liabilities. However, Staff acknowledged that excessive restrictions on termination liabilities could reduce SBC Illinois' willingness to provide discounted service to customers and that it should not be held to a "higher standard" than its competitors in the business marketplace. Staff Ex. 2.0 (Koch Direct) at 5-6, 12. Therefore, Staff recommended that the Commission establish guidelines applicable to all carriers. *Id.* at 13.

SBC Illinois agrees with Staff that, if the Commission concludes that only TDS' approach to termination liabilities is lawful, then it should be imposed in an even-handed manner on all carriers in Illinois. SBC Ill. Ex. 1.0 (Gillespie Direct) at 45; SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 18. A rulemaking proceeding would be the appropriate means of achieving that result. However, SBC Illinois does not believe that either Staff or TDS have demonstrated that SBC Illinois' approach is unlawful and that only the TDS approach is lawful. At most, TDS and Staff have demonstrated that "give-back-the-unearned-discount" is an approach that *could* be used by a carrier in Illinois. They have not demonstrated that it *must* be used. *Id.*

As noted above, Staff's position that TDS' approach is superior is not based on fact. Staff's principal concern is that SBC Illinois' forward-looking approach would result in higher termination charges than TDS' approach in all but the "last few months" of a contract term. Staff Ex. 2.0 (Koch Direct) at 8. This is incorrect. Staff's example calculation was itself in error and, as explained above, SBC Illinois' approach produces lower termination charges than TDS' in over 60% of the months in the typical contract term. SBC Ill. Ex. 2.1 (Frankel Rebuttal) at 9-11. Thus, Staff's position is based on a fundamental misconception as to the relative financial impact of the two approaches.

Staff further contended that there is a "possibility" that the contracts in question could result in "...locking up customers and, thus, adversely affecting the marketplace." Staff Ex. 1.0 (Omoniyi Direct) at 14. Whether or not any given termination liability practice has that effect requires an analysis of marketplace dynamics – something which Staff did not supply. SBC Illinois showed that its revised policies are reasonable and that customers are *not* being "locked up." Indeed, Dr. Frankel testified that TDS had not advanced even a "plausible theory of anticompetitive harm" and Staff did not add to it in any way. SBC Ill. Ex. 2.0 (Frankel Direct) at 30.

Moreover, Staff's position in this proceeding is inconsistent with the informal guidelines that Staff has used both with SBC Illinois and the other CLECs in Illinois. As Staff explained, it held workshops pursuant to Finding (15) of the *Ascent Order* to review CLEC termination liability policies and to determine whether any further Commission action was required. Staff Ex. 2.0 (Koch Direct) at 5-6. Staff attempted to persuade the CLECs to reduce their termination liabilities on a voluntary basis. It is SBC Illinois' understanding that the CLECs were being urged by Staff to move to a *50%* termination liability and that these efforts were largely unsuccessful. *Id.*; SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 9-10. No further Commission action was initiated at that time relative to the CLECs' practices, despite the fact that many of the CLECs' termination liabilities substantially exceeded this benchmark. In adopting the policies being considered in this proceeding, SBC Illinois' objective was to follow contract and economic theory, as well as its understanding of what would be acceptable to Staff. All of its proposed termination liabilities are 50% or lower. Having made these changes based on a good faith assumption that they would fall well within Staff's "range of reasonableness," Staff's apparent change of heart is baffling to the Company. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 11-12.

Neither SBC Illinois nor TDS are supportive of Staff's rulemaking proposal, although for different reasons. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 18-23; TDS Ex. 1.5 (Loch Rebuttal) at 7. All parties agree that such a proceeding would be costly and burdensome. Even Staff concedes that this rulemaking would be a "large scale endeavor." Staff Ex. 2.0 (Koch Direct) at 13. TDS contends there is enough evidence in the record to impose its preferred approach to termination liabilities on SBC Illinois alone. SBC Illinois disagrees. Not only would it be inappropriate to single SBC Illinois out for special treatment – as even Staff agrees – there is no record that would support such an action. Neither TDS nor Staff has presented sufficient evidence to justify imposing the "give-back-the-unearned-discount" methodology on either SBC Illinois alone or on the entire industry. Under these circumstances, SBC Illinois urges the Commission to simply deny TDS' Complaint and terminate the proceeding.

Nor should a rulemaking proceeding be considered a benign and costless alternative to resolving the issues raised by TDS at this time. The mere fact of a rulemaking will disrupt competitive behavior in the Illinois marketplace. The rulemaking will cast a cloud over the contracting policies of every carrier in this state (other than TDS). Carriers will not know whether they can rely on their existing termination liability policies when developing customer discounts or pricing a customer-specific network. This could have the effect of chilling any such arrangements during the pendency of the rulemaking proceeding. If carriers are forced to play it "safe" from a financial perspective during the period that the rulemaking proceeding is pending, customers will be the losers. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 22.

For these reasons, SBC Illinois urges the Commission not to embark on a rulemaking proceeding lightly. Given the fact that Staff favors the TDS approach, the record in this complaint proceeding provides a reasonable proxy for what would likely result from the rulemaking proceeding. The only difference is that other CLECs would also weigh in on the issues. Based on past experience in the workshops, SBC Illinois expects every CLEC in Illinois other than TDS to object to any effort by the Commission to impose TDS' approach on them by regulatory fiat. Unless the Commission, based on the record developed in this proceeding, believes that it is likely to adopt TDS' approach over the opposition of virtually the entire telecommunications industry in Illinois, a rulemaking proceeding would be a costly and unproductive exercise. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 18-19.

More significantly, regulation of the industry's termination liability practices could negatively impact customers and competition. Pricing is at the heart of the competitive marketplace. As Staff concedes, there is an integral relationship between the prices that carriers offer customers (i.e., the level of discount) and the termination liability policy that they can apply. Staff Ex. 2.0 (Koch Direct) at 5. Moreover, a carrier's willingness to even provide customers with custom telecommunications solutions is directly related to termination liabilities that allow it to fully recoup losses in the event of early termination. Therefore, the Commission should be extremely cautious about regulating carrier conduct that directly affects both *prices* and *service*. Moreover, adopting industry-wide guidelines in this area would run counter to this Commission's long-standing, procompetitive policies. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 19-21.

In addition, the Illinois Public Utilities Act does not contemplate regulatory intervention into carriers' contracting practices for the reasons suggested by Staff. Section 13-509 of the Act allows companies to enter into contracts on an "off tariff" basis for competitive services and limits the circumstances under which the Commission can second guess the terms of such contracts:

> "...Upon submitting notice to the Commission of any such agreement, the telecommunications carrier shall thereafter provide service according to the terms thereof, unless the Commission finds, after notice and hearing, that the continued provision of service pursuant to such agreement would substantially and adversely affect the financial integrity of the telecommunications carrier or would violate any other provision of this Act."

Under this section, contract terms can be altered by the Commission only in the event of severe financial risk to the carrier or unlawfulness. It does not contemplate regulation merely to achieve a "better" competitive result, which is what Staff is proposing.

In short, Staff bears a substantial burden to justify requiring that the entire industry in Illinois embark on an expensive and potentially risky examination of termination liabilities policies. SBC Illinois fully agrees with Staff that the Commission should treat all carriers on an even-handed basis. However, the record in this proceeding demonstrates that parity of treatment should be achieved by permitting carriers to make their own decisions, and allowing the marketplace to discipline carriers that exceed the bounds of what customers will accept.

## VI. TDS' REQUESTS FOR RELIEF SHOULD BE DENIED

TDS' primary request for relief is that the Commission order SBC Illinois to substitute TDS' backwards-looking termination liability policy for the Company's forward-looking policy in all tariffs and contracts. As has been discussed in detail in this Initial Brief, TDS has not met its burden of proof on this issue and its request for relief should be denied. Similarly, TDS has not met its burden relative to its alternative request that the Commission set a 25% cap on SBC Illinois' forward-looking termination liabilities or that the Commission require SBC Illinois to calculate termination liabilities directly for CLECs.

Accordingly, TDS' other requests for relief fail as well. SBC Illinois should not be required to reimburse TDS for its legal fees and expenses.[11] TDS Ex. 1.5 (Loch Rebuttal) at 9-10. TDS is only entitled to its legal expenses and costs under Section 13-516 (a)(3) if the Commission finds that SBC Illinois has violated Section 13-514 of the Act. Section 13-514 prohibits carriers from "knowingly imped[ing] the development of competition in any telecommunications service market." TDS has not made any such showing in this proceeding. Not only has TDS failed to show that SBC Illinois' termination liability policies have "impeded competition" at all, it has not even begun to demonstrate that those policies were adopted in a "knowing" attempt to do so. Therefore, there is no factual basis on which an award of attorney's fees and related costs could be made.

TDS makes the argument in its rebuttal testimony that it should be awarded attorney's fees even if the Commission *approves* SBC Illinois' current termination liability policies. TDS contends as follows:

> "SBC has not really attempted to defend its previous termination charge policies, but rather has defended against the complaint primarily on the grounds that it is adopting new termination liability policies . . . Further, it is clear that SBC Illinois did not really devote any significant attention and resources to comprehensively reviewing and revamping its termination liability provisions into a consistent set of policies, with lower percent of remaining revenue charges, until prodded to do so by TDS Metrocom's complaint . . . Therefore, even if the Commission does no more in this case than approve SBC's new, less onerous termination liability policies, it is clear that the filing of TDS Metrocom's complaint has resulted in a benefit to CLECs, consumers and the competitive telecommunications market in Illinois, which I understand provides appropriate justification for ordering SBC Illinois to reimburse TDS Metrocom for its legal fees and costs." TDS Ex. 1.5 (Loch Rebuttal) at 9-10.

This is not a rationale that supports the award of attorney's fees and costs under Section 13-516(a)(3). It is well established that Section 13-516, like other fee-shifting statutes, is to be

[11] Although TDS also requested penalties and damages in its Complaint, SBC Illinois understands that TDS is now only seeking attorney's fees and related costs. TDS Ex. 1.5 (Loch Rebuttal) at 9-10.

strictly construed. *Globalcom, Inc. v. Ill. Comm. Comm. and Ill. Bell Telephone Co.*, Nos. 1-02-3605, 1-03-0068 Consol., slip op. at 36 (1st Dist. 2004). Thus, the Commission must find a violation of Section 13-514 to require SBC Illinois to reimburse TDS for its expenses. Nothing in Section 13-516 contemplates such payments merely because a carrier modifies its policies voluntarily. The issue is whether SBC Illinois' current policies are anticompetitive – and they are not. If there are not violative of Section 13-514, then there is no basis for an award of costs to TDS.[12]

Moreover, even with respect to SBC Illinois' original policies, TDS has not demonstrated that they were either anticompetitive or that SBC Illinois had adopted them with the *intent* of impeding competition. Although SBC Illinois has urged the Commission to resolve the disputed issues in this proceeding based on its modified policies, that does not mean that its prior policies were unlawful. For usage products not subject to the *Ascent Order*, termination liabilities since 2002 have ranged from 35% to 50%. These levels are fully supported by SBC Illinois' financial analysis presented in this proceeding and Staff's informal guidelines used in the workshops. Therefore, these termination liabilities cannot be considered unreasonable. The majority of transport products were previously subject to a "give-back-the-unearned-discount" methodology, an approach which Staff and TDS *support*. The *only* major product whose termination liability historically exceeded 50% is Centrex, which typically has been subject to an 85% termination liability (although customers were allowed to disconnect up to 20% of their lines before the termination liability was charged). Although SBC Illinois has lowered this amount to 25%, its

[12] SBC Illinois notes that the issues raised by TDS do not implicate any of the *per se* prohibitions in Section 13-514(1)-(12). Since they fall only with the generic penumbra of Section 13-514, TDS should bear a heavy burden to demonstrate a statutory violation. Otherwise, Section 13-514 simply becomes a catchall provision for any conduct to which another carrier might object. Given the severe sanctions imposed in Section 13-516, such an interpretation would be contrary to the legislature's intent in enacting these provisions and would leave carriers essentially without notice as to the conduct that could trigger the remedies in Section 13-516.

prior Centrex termination liability was fully justified in light of market conditions.[13] Notably, most CLECs offering Centrex service charge *100%* termination liabilities. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 5-6. There is no contrary evidence in the record.

In any event, the TDS Complaint did not *cause* SBC Illinois' change in policy – it simply accelerated a process that was already underway. SBC Illinois had already concluded that its termination liability policies needed to be rationalized for business and marketing reasons. Thus, tariffs for new products and services were being filed with termination liabilities consistent with the new policies and older tariffs were being updated as other changes were made prior to the filing of TDS' Complaint. SBC Ill. Ex. 1.0 (Gillespie Direct) at 17-18. These modifications were made on an incremental basis because significant internal work was required to implement them, both relative to systems and personnel. *Id.* at 14-15. The fact that TDS' Complaint prompted SBC Illinois to move up the timetable, and to incur the costs and disruption associated with implementing them all at once, is not grounds for imposing yet more costs on SBC Illinois.

Even if TDS' argument had merit – which it does not – SBC Illinois notes that the Company announced the changes to its termination liability policies in December of 2003, shortly before TDS filed its direct testimony. TDS Ex. 1.0 (Loch Direct) at 17. Any "benefits" which TDS' Complaint conferred on customers and competitors were complete at that point. Legal expenses and costs incurred by TDS since December have been entirely at TDS' discretion

[13] SBC Illinois' termination liability policy assumes that all of the underlying network costs are avoidable – in other words, reusable. This is likely to be an optimistic assumption even on a going-forward basis and it was certainly not borne out over the last several years. Between 2001-2003, lines (and profits) lost when customers migrated to CLECs were not offset by new demand. The stranding of facilities when a customer moves from a network solution like Centrex to a premises solution like a PBX is particularly acute, because Centrex requires many more loops than a comparably-sized PBX. Thus, the Company could have legitimately included network costs in determining its termination liability for Centrex during that period, justifying an 85% or higher termination liability calculation. The fact that SBC Illinois has taken a much more conservative approach with its 25% termination liability proposal does not mean that its prior approach was unlawful. SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 5-6.

and have been directed at persuading the Commission to adopt *TDS' approach* to termination liabilities. Thus, SBC Illinois itself has been forced to incur considerable litigation costs, including the expenses associated with the outside economist who testified in this proceeding. SBC Illinois should not be required to pay legal expenses and costs incurred by TDS to contest the very policies that TDS now concedes the Commission may approve.

## VII. CONCLUSION

The Commission should deny TDS' Complaint in its entirety. TDS is asking the Commission to expand its *Ascent Order* to cover all of the products and services that SBC Illinois offers under term agreements. However, the *Ascent Order* was a response to a 100% termination liability policy that SBC Illinois has not used since 2002 and to a perceived lack of competition in the marketplace when the ValueLink services were introduced in the 1996-98 time frame. The world is vastly different today. SBC Illinois' current termination liabilities fall well within a range of reasonableness based on contract law, economic principles and the conduct of other carriers in the marketplace. The marketplace should be allowed to determine the practices of carriers in this area and the Commission should not attempt to micromanage them.

Respectfully submitted,

ILLINOIS BELL TELEPHONE COMPANY

________________________________
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## CERTIFICATE OF SERVICE

I, Louise A. Sunderland, an attorney, certify that a copy of the foregoing **INITIAL BRIEF OF SBC ILLINOIS** was served on the parties on the attached service list by U.S. Mail and/or electronic transmission on June 11, 2004.

Louise A. Sunderland

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